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No. 84-679

In the Supreme Court

OF THE

United States

OCTOBER TERM 1984

BATEMAN EICHLER, HILL RICHARDS, INCORPORATED
Petitioner,

VS.

CARL F. BERNER, CHARLES BRUNER, DENNIS T. DEMETRE, LAWRENCE EPSTEIN, BARRY S. GLASS, HERBERT GREENBAUM, ROBERT M. JACOBS, ARNOLD R. KEILES, HARRY MITTLEMAN, GARY L. NOBEL, CHARLES P. LAZZARO, LESLIE L. NEADEAU and T.O.N.M. OIL & GAS EXPLORATION CORPORATION,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF PETITIONER

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QUESTIONS PRESENTED

1. Should the common law *in pari delicto* defense bar implied private fraud actions under the federal securities laws by an admitted tippee-securities law violator against his alleged tipper?

2. Is the availability of the *in pari delicto* defense in actions implied under the securities laws attenuated or eliminated by considerations this Court articulated in its decision in *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134 (1968), examining the availability of the defense in private actions expressly granted by the antitrust laws?

3. If the *in pari delicto* defense applies to implied securities fraud actions, are plaintiffs here barred from proceeding because their conduct was "substantially equal" in fault to that of the defendants?[1]

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[1]Petitioner Bateman Eichler, Hill Richards, Incorporated has the following parent company: Batehill, Inc., which in turn is a wholly-owned subsidiary of Kemper Corporation. Petitioner has no other parent company, subsidiary, or affiliate within the meaning of Supreme Court Rule 28.1.

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CARL F. BERNER, CHARLES BRUNER, DENNIS T. DEMETRE, LAWRENCE EPSTEIN, BARRY S. GLASS, HERBERT GREENBAUM, ROBERT M. JACOBS, ARNOLD R. KEILES, HARRY MITTLEMAN, GARY L. NOBEL, CHARLES P. LAZZARO, LESLIE L. NEADEAU and T.O.N.M. OIL & GAS EXPLORATION CORPORATION,
Respondents.

BRIEF OF PETITIONER

OPINIONS BELOW

The opinion of the Ninth Circuit Court of Appeals rendered April 13, 1984 and amended July 26, 1984 is reported at 730 F.2d 1319 (9th Cir. 1984) and is Appendix A ("Pet. App. A-1") to the petition for certiorari ("petition"). The order of the Ninth Circuit Court of Appeals amending the opinion and denying rehearing and rehearing en banc was entered July 26, 1984 and is Appendix B to the petition. The unreported order of the United States District Court for the Central District of California was entered April 18, 1983 and is Appendix C to the petition ("Pet. App. C-1").

JURISDICTION

The judgment of the Ninth Circuit Court of Appeals was entered on April 13, 1984. A petition for rehearing with a suggestion for rehearing en banc was timely filed on April 30, 1984. The petition for rehearing was denied and the opinion was modified by an undated order entered July 26, 1984. The petition for writ of certiorari, invoking the jurisdiction of the Supreme Court pursuant to 28 U.S.C. § 1254(1) (1982), was timely filed within ninety days thereafter. (28 U.S.C. § 2101(c) (1982); Supreme Court Rule 20.2, 20.4.) This Court granted the petition on January 7, 1985.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case involves Section 10(b) of the Securities Exchange Act of 1934 (the "Securities Exchange Act"), 15 U.S.C. § 78j(b) (1982); Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 (1985); and Section 17(a) of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. § 77q(a) (1982). These statutory provisions are printed in full in the appendix to this Brief ("Brief App.") at A-1-2.

The issues presented also are affected by Section 16 of the Securities Act, 15 U.S.C. § 77p (1982); Section 28(a) of the Securities Exchange Act, 15 U.S.C. § 78bb(a) (1982); and the provisions of the recently enacted Insider Trading Sanctions Act of 1984, 1984 U.S. Code Cong. & Ad. News (98 Stat.) 1264, to be codified at Section 21(d) of the Securities Exchange Act, 15 U.S.C. § 78u(d). Section 16 of the Securities Act, 15 U.S.C. § 77p (1982), states:

> The rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity.

Section 28(a) of the Securities Exchange Act, 15 U.S.C. § 78bb(a) (1982), contains the same provision. The provisions of the Insider Trading Sanctions Act are printed in full at Brief App. A-2-6.

The issues in this case also may be affected by Section 4 of the Clayton Act of 1914, 15 U.S.C.A. § 15 (West Supp. 1984), which states:

> [A]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.

STATEMENT OF THE CASE

Plaintiffs, admitted tippee-stock purchasers, allege that they obtained tips of actual and supposed material inside information on a public company from a representative of a broker-dealer. They then acted to confirm the tips with a corporate insider whom they understood to be the original source. Thereafter, believing they had confirmed the tips, they repeatedly defrauded innocent sellers of the stock by buying "substantial amounts" of the stock without disclosing the information they had unlawfully obtained. Disappointed that their scheme did not prove profitable, plaintiffs then sued to recover their anticipated but unrealized profits and to recoup their losses from their alleged tippers on the premise that the tips were false or misleading.

The district court dismissed the complaint on the ground that plaintiffs had themselves violated the securities laws

by these acts, and therefore the doctrine of *in pari delicto* barred their claims. (Pet. App. C-2). The Court of Appeals for the Ninth Circuit reversed the dismissal, thereby enabling these plaintiffs to utilize the process of the federal courts to secure the fruits of their own fraud free of the *in pari delicto* defense.

The complaint presents claims for violation of federal and state securities laws and state statutory and common law fraud. The only claims at issue here are one under Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b) (1982), and Rule 10b-5, 17 C.F.R. 240.10b-5 (1985), and one under Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a) (1982).[2] Jurisdiction of the district court was invoked under Section 22 of the Securities Act, 15 U.S.C. § 77v (1982), and Section 27 of the Securities Exchange Act, 15 U.S.C. § 78aa (1982).

The complaint sets forth all the facts necessary for application of the *in pari delicto* defense.[3] It alleges that plaintiffs purchased the publicly traded stock of T.O.N.M. Oil & Gas Exploration Corporation ("T.O.N.M.") expressly "on the premise" that information plaintiffs had received from

[2]The Ninth Circuit affirmed the district court's dismissal of an additional purported federal securities law claim under Section 15 of the Securities Exchange Act, 15 U.S.C. § 78o (1982), which is not in issue here.

[3]An assessment of the availability of an *in pari delicto* defense requires an analysis of the relative culpability of the plaintiff and the defendant. Because the complaint pleaded the facts underlying plaintiffs' violations of the securities laws in unusual detail, the district court was able to weigh the relative culpability of the plaintiff and the defendants in the context of Bateman Eichler, Hill Richards, Incorporated's motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6) without requiring any fuller factual development. In another context, this Court has done the same and found an absence of justiciable controversy when pleadings alone were sufficiently detailed to present an *in pari delicto* issue in an appropriate posture for review. *See, e.g., The St. Louis, Vandalia & Terre Haute R. Co. v. The Terre Haute & Indianapolis R. Co.*, 145 U.S. 393, 408 (1891) (on appeal from dismissal of bill in equity, facts showed parties were *in pari delicto*).

Charles Lazzaro, a Bateman Eichler, Hill Richards, Inc. ("BEHR") broker, was "information not otherwise available to the general public." (Complaint ¶ 15; Joint Appendix ("Jt. App.") at 10.)

According to the complaint, Lazzaro induced plaintiffs to purchase T.O.N.M. stock by telling them that he knew T.O.N.M.'s president and/or vice-president personally and that he had learned the following non-public information about the company: T.O.N.M. had acquired rights to a large gold deposit discovered in Surinam; it was about to enter into a joint venture agreement with a large mining company to mine the gold; it would issue to its shareholders stock in its subsidiary without additional consideration; and for these reasons the value of T.O.N.M. stock would increase dramatically from $1.50 per share to between $10

Other courts presented with complaints detailing sufficient facts to provide the basis for an analysis of relative culpability have decided the availability of the *in pari delicto* defense to securities claims at the pleading stage. *See, e.g., In re Haven Industries, Inc.*, 462 F. Supp. 172, 173, 178-80 (S.D.N.Y. 1978) (upholding *in pari delicto* defense raised in motion to dismiss pursuant to Fed.R.Civ.P. 12(b)(6) and motion for summary judgment pursuant to Fed.R.Civ. P. 56 by reference to allegations of complaint establishing plaintiffs' own violations); *see also Grumet v. Shearson/American Express, Inc.*, 564 F. Supp. 336, 341 n.3 (D.N.J. 1983) (entering summary judgment for defendants based upon *in pari delicto* doctrine and denying additional discovery because "allegations of the complaint are sufficient for purposes of analysis of the *in pari delicto* defense").

and $15 per share when T.O.N.M. publicly released the information. (Complaint ¶¶ 16-18; Jt. App. 11-12.) Lazzaro also told plaintiffs that he and his relatives owned, and were holding throughout the period relevant to the complaint, a large block of T.O.N.M. stock. (Complaint ¶ 16(i); Jt. App. 12.)[4]

[4]The complaint detailed Lazzaro's alleged representations as follows:

> a. Vast amounts of gold had been discovered in Surinam, and TONM had options on thousands of acres in gold-producing regions of Surinam.
>
> b. The find had been verified by geological reports and the find compared favorably to, if not better than, those in South Africa.
>
> c. The presence of the find and the geological report(s) were not publicly known, but would subsequently be announced.
>
> d. The development of the Surinam gold fields would not require deep mining. Geologists in Surinam were finding gold nuggets in dry creek beds.
>
> e. TONM was negotiating with the St. Joseph Mining & Mineral Company, and possibly other large companies, from as early as February, 1980, to engage in a joint venture to mine the gold in Surinam.
>
> f. The St. Joseph Mining & Mineral Company was to invest two hundred million dollars to mine the gold in Surinam.
>
> g. After that announcement, Lazzaro stated that TONM stock would go up 6-11 points. Thus, TONM stock, which was then selling from $1.50 to $3.00/share, would increase in value to $10 to $15/share within a short period of time, and that [sic] it might increase to $100/share by the end of 1980.
>
> h. TONM shareholders would *automatically* receive 1 share of IGDE for every 5 shares of TONM stock without the payment of any additional monies.
>
> i. Lazzaro and his relatives owned a large block of TONM stock, and neither Lazzaro nor any of his relatives were, at any time, selling their TONM stock.

(Complaint ¶ 16; Jt. App. 11-12.)

Plaintiffs did not passively rely on this information. Instead, they undertook to confirm it before commencing a purchasing plan which required, for its success, that plaintiffs withhold these "tips" from the other parties to their trades. Plaintiffs thus contacted T.O.N.M. president Leslie Neadeau to verify the accuracy of their "tips," but Neadeau would neither confirm nor deny them. Significantly, plaintiffs did learn from Neadeau, however, that such information was "not public knowledge" and that Lazzaro was "very trustworthy and a good man." (Complaint ¶ 19; Jt. App. 12.)[5]

With confidence that they possessed inside information and could obtain stock from unwitting sellers at a fraction

The Complaint further stated:

> Lazzaro represented that he knew personally the President and/or Vice-President of TONM and TONM was going to announce publicly by April, 1980, that St. Joseph's Mineral & Mining Company was entering into a joint venture with TONM.

(Complaint ¶ 17; Jt. App. 12.)

[5]The complaint described plaintiffs' conversation with Neadeau, in which plaintiffs implicitly verified Lazzaro's claims, as follows:

> 19. In or about April, 1980, certain plaintiffs contacted Leslie L. Neadeau, President of TONM, to attempt to verify Lazzaro's claims concerning the Surinam gold find and whether TONM was going to enter into a joint venture agreement with St. Joseph Mining & Mineral Company or with any other company for the exploration and mining of gold in Surinam. Mr. Neadeau would neither confirm nor deny those claims, stating that they were not public knowledge and that plaintiffs would have to wait for the publication of TONM's annual report. Mr. Neadeau was specifically advised that plaintiffs were dealing with Lazzaro, and Mr. Neadeau told the plaintiffs that he could say that Lazzaro was very trustworthy and a good man.

(Complaint ¶ 19; Jt. App. 12.)

of its true value, plaintiffs then purchased T.O.N.M. stock in the public markets from November 1979 through much of 1980 without disclosing the information to the sellers. (Complaint ¶¶ 15, 24; Jt. App. 10, 14.) These were not casual purchasers. Rather, they engaged in a studied scheme to defraud. Throughout, plaintiffs believed that they were trading, and in fact they admit that they did trade, on material non-public information, which they knew came from Neadeau. Meanwhile, the price of T.O.N.M. stock did rise to $7 per share in late 1980. Then, with public news that the negotiations between T.O.N.M. and its prospective joint venturer had terminated and that no new negotiations were contemplated, the stock fell sharply to less than $1 per share in the second quarter of 1981. (Complaint ¶¶ 20, 25; Jt. App. 13, 14.)

Plaintiffs, unwilling to bear the losses their illegal conduct occasioned, sought by this suit to recover their losses and their anticipated profits from their alleged tippers on the basis that some of the non-public information was false or incomplete. Defendants BEHR and Lazzaro moved to dismiss the complaint under Federal Rule of Civil Procedure 12(b)(6).[6] In ruling on that motion, the United States District Court for the Northern District of California (District Judge William W. Schwarzer) necessarily accepted as true the material, well-pleaded allegations of plaintiffs' complaint. *See Miree v. DeKalb County*, 433

[6]Defendants T.O.N.M. and Neadeau, who held approximately 100,000 T.O.N.M. shares, were not parties to BEHR's and Lazzaro's motion to dismiss.

T.O.N.M. is presently a debtor in possession pursuant to a Chapter 11 proceeding in the United States Bankruptcy Court for the Central District of California, *In re T.O.N.M. OIL & GAS EXPLORATION CORPORATION, a New Mexico Corporation*, No. LA 84-13915-CA (filed June 29, 1984).

U.S. 25, 27 n.2 (1977).[7] These detailed allegations established that plaintiffs traded upon what they believed to be material inside information originating with a corporate officer who was duty-bound not to release that information for personal gain.

Concluding that plaintiffs had themselves violated the securities laws they charged defendants with violating, the district court dismissed the suit as to all defendants. This dismissal was based on the then-unanimous law of the federal courts of appeals, as articulated most specifically in decisions of the Third and Fifth Circuit Courts of Appeals, denying to such plaintiffs a judicial remedy to obtain the benefits of their own violation of the federal securities laws. (Pet. App. C-2.)

Plaintiffs appealed the dismissal to the Ninth Circuit Court of Appeals, and the Securities and Exchange Commission ("SEC") filed a brief as amicus curiae and presented oral argument there. The Ninth Circuit Court of Appeals reversed and held that these tippees, who wilfully traded on material inside information with an intent to defraud innocent investors, nevertheless are immune from the bar of the *in pari delicto* defense in a lawsuit against a broker and a corporate insider. The court below explicitly recognized that it had "reached a result in this matter which is contrary to the views expressed in *Tarasi v. Pittsburgh National Bank*, 555 F.2d 1152 (3d Cir. 1977), *cert. denied*, 434 U.S. 965, 98 S. Ct. 504, 54 L.Ed.2d 451 (1971), and *Kuehnert v. Texstar Corp.*, 412 F.2d 700 (5th Cir. 1969)." (Pet. App. A-10; 730 F.2d at 1324.) The court did not mention the decisions of the Eleventh and Fourth Circuit Courts of Appeals, which upheld the availability of the *in pari delicto* defense. *See Silverberg v. Paine, Webber, Jackson & Curtis, Inc.*, 710 F.2d 678 (11th Cir. 1983), con-

[7]Defendants Lazzaro and BEHR deny the truth of plaintiffs' charges. However, of course, the allegations are assumed to be true, *arguendo*, in the context of a motion to dismiss.

cluding that the *in pari delicto* defense was available in securities cases although the facts of that particular case did not warrant applying the defense, and *Malamphy v. Real-Tex Enterprises, Inc.*, 527 F.2d 978 (4th Cir. 1975), approving application of the *in pari delicto* defense against an investor asserting common law claims.

Even though the court of appeals below acknowledged that the plaintiffs-tippees in the present case and in *Tarasi* and *Kuehnert* also "violated the federal securities laws," the court, without any analysis of plaintiffs' conduct here or there, rejected what it characterized as those courts' conclusion that "a duped investor is equally at fault in the fraud perpetrated against him by his broker or an insider." (Pet. App. A-10-11; 730 F.2d at 1324.) Plaintiffs, of course, were not "duped investors" but rather were themselves active and eager participants in a fraud on innocent investors. Furthermore, defendant brokers and corporate insiders owe the same duty under Rule 10b-5 to the securities markets as do "any person[s]," including tippees like plaintiffs who trade knowing they improperly have obtained material, non-public information.

The court of appeals' decision rested on a second error as well: the premise that in the securities law context, "[p]ublic policy encourages private actions as enforcement devices for the public interest, even though a windfall may accrue to a wrongdoing plaintiff." (Pet. App. A-4-5; 730 F.2d at 1321.) The court of appeals reached this conclusion by mistaken reliance on *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134 (1968), where this Court restricted the circumstances under which the *in pari delicto* defense might be applied to bar statutorily created "private attorney general" antitrust actions. The court of appeals ignored the crucial differences between actions under such express enforcement provisions of the federal antitrust laws and implied actions under the securities fraud laws, which are discussed in full in Section II.C.2.

The court simply assumed that implied private actions by persons in the position of plaintiffs were necessary to serve the market-protecting aims of the Securities Act and the Securities Exchange Act (Pet. App. A-7-8; 730 F.2d at 1322-23), without considering the intent of Congress, the harm that would inure to the judicial system as a result of providing a forum for relief to wrongdoers, or the adverse impact its conclusion would impose on the securities markets by dramatically reducing the risks assumed by tippees who knowingly trade on inside information.

SUMMARY OF ARGUMENT

The principle of *in pari delicto*, deeply rooted in English and American common law, directs courts to leave parties as they find them when, as here, a plaintiff and defendant come before the court in a condition of substantially equal fault. That principle, which preserves the integrity of the judicial process and discourages wrongdoing, was incorporated into the securities laws when Congress enacted them against a background of common law tradition and expressly preserved common law rights and remedies. The courts have more fully drawn the doctrine into the securities regulatory scheme by relying on common law principles in implying a private right of action under certain sections of the securities laws, including Section 10(b) of the Securities Exchange Act, that did not expressly provide one.

In *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134 (1968), this Court fashioned a judicial limitation on the application of the *in pari delicto* defense in statutorily created private antitrust actions. That limitation was consistent with the doctrine as it had developed at common law — barring the defense where plaintiff's conduct was much less culpable than defendant's or where a statute operated to override the defense. Both the letter and spirit of the *Perma Life* decision dictate the preservation and invocation of the *in pari delicto* defense here.

Unlike the *Perma Life* plaintiffs, plaintiffs here have without any coercion — indeed eagerly and repeatedly — violated the securities laws by defrauding innocent investors. They admittedly did so by trading without disclosing actual and supposed material non-public information they knew was wrongfully obtained. Their *delictum*, as pleaded, is thus at least *par* with defendants.

Also unlike the *Perma Life* plaintiffs, plaintiffs here are not presenting claims based upon a statute which can be said to override the common law defense. The federal securities provisions relied upon by plaintiffs, which expressly grant no private right of action, naturally do not reflect any Congressional intention to give private actions preeminence over common law rights and defenses. To the contrary, the right to bring such actions under Section 10(b) and Rule 10b-5 is implied by reference to the same common law that creates and preserves the *in pari delicto* defense. The common law, in contrast, did not provide a private right of action for victims of antitrust violations in the years pre-dating the Sherman Antitrust Act. There thus is no basis to conclude that any congressional policy encouraging enforcement of the federal securities laws through implied private actions even exists, much less that it can or should predominate over the traditional strong interest of the courts in protecting their own integrity by refusing to provide a forum where wrongdoers can reap the fruits of their misdeeds.

ARGUMENT

I

PLAINTIFFS HAVE ALLEGED CONDUCT WHICH REVEALS THAT THEY HAVE VIOLATED THE VERY LAWS UPON WHICH THEIR CLAIMS DEPEND.

The complaint is rife with allegations that show plaintiffs' conduct was grossly culpable under the federal

securities laws. Plaintiffs have admitted that (1) they believed, after seeking actively to confirm it, that they had material inside information about a stock, (2) they did in fact have inside information, and (3) they knew this information came from a high-ranking insider. They also admitted that, acting with scienter, they fraudulently failed to reveal that information when they traded with investors who only had access to public information about the stock.

Plaintiffs' conduct places them squarely within the class of parties required to disclose inside information by this Court's decisions in *Chiarella v. United States*, 445 U.S. 222 (1980), and *Dirks v. S.E.C.*, ___ U.S. ___, 103 S. Ct. 3255 (1983). In *Chiarella*, this Court held that no duty to disclose material, non-public information prior to trading arises under Rule 10b-5 if the trader has not obtained the information by breach of a fiduciary duty he owes to corporate shareholders. In *Dirks*, this Court expanded upon its decision in *Chiarella* and held that the duty of a tippee to disclose or abstain from trading on inside information derives from the fiduciary duty that the insider tipper owes the corporation's shareholders. 103 S. Ct. at 3264. This Court established a test for measuring breach of fiduciary duty by inquiring into whether the tipping insider secured a direct or indirect personal gain. This test focuses upon "objective criteria" such as "pecuniary gain or a reputational benefit that will translate into future earnings." *Id.* at 3265-66 (citing *Cady, Roberts & Co.*, 40 S.E.C. 907, 912 n.15 (1961)).[9]

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[9]Corporate insiders also are forbidden under Section 10(b) from making a gift of inside information. *Dirks v. S.E.C.*, *supra*, 103 S. Ct. at 3263.

Where an insider does not tip for an improper purpose, a tippee does not breach his derivative duty when he trades. *Id.* at 3265-66. But when, as here, a tippee knows that the insider has tipped for an improper purpose, the tippee does acquire a derivative duty not to trade. This Court made the point in *Dirks*:

> Not only are insiders forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage, but they may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain. *See* 15 U.S.C. § 78t(b) (making it unlawful to do indirectly "by means of any other person" any act made unlawful by the federal securities laws). Similarly, the transactions of those who knowingly participate with the fiduciary in such breach are "as forbidden" as transactions "on behalf of the trustee himself."

Id. at 3263.

This Court's opinion continued:

> Thus, a tippee assumes the fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach.

Id. at 3264.

Plaintiffs' admissions here establish repeated violations of their duty not to trade. Plaintiffs learned material inside information from Lazzaro, who represented that he knew personally the president, Neadeau, and/or vice-president of T.O.N.M. (Complaint ¶ 17; Jt. App. 12.)[9] Plain-

[9]Neadeau and T.O.N.M. allegedly also conspired with Lazzaro to manipulate the market for T.O.N.M. stock, which Neadeau, Lazzaro and members of his family held in substantial quantities. (Complaint ¶¶ 8, 9, 16(i); Jt. App. 8, 12.)

tiffs checked with Neadeau, who advised them that the information was non-public (hence they knew they should not have received it and must not trade on it) and who implicitly affirmed that Lazzaro was to be trusted in passing along non-public information. (Complaint ¶ 19; Jt. App. 12). Plaintiffs thus knew that Lazzaro's information came from an insider who had a duty not to disclose the information but who did disclose it for a wrongful purpose of personal gain and in all events in derogation of his duty to treat shareholders of his company fairly. *See Zahn v. Transamerica*, 162 F.2d 36, 46-47 (3rd Cir. 1947). For that matter, plaintiffs also knew that the broker stood to benefit personally from his substantial holdings in T.O.N.M. and right to commissions. (Complaint ¶ 16(i); Jt. App. 12). Accordingly, plaintiffs inherited the insider's duty not to trade on that non-public information and cannot escape the conclusion that they violated the securities laws. Hence, the doctrine of *in pari delicto* bars their claims.

Plaintiffs may contend, however, that certain of defendants' representations detailed in the complaint were untrue. This argument fails for two reasons. First, the complaint apparently is predicated on the theory that while Lazzaro failed to disclose some material facts, certain of his inside information was true. Thus, plaintiffs do not allege that they did not receive any real inside information at all. Indeed, they concede that they did trade on true inside information, that there was a gold find, and that negotiations between T.O.N.M. and a mining company for a joint venture were underway. Plaintiffs pleaded specifically that in January 1981, "TONM announced that the negotiations for a joint venture [to mine the gold]

had terminated and that no new negotiations were contemplated." (Complaint ¶ 20; Jt. App. 13.)[10]

Second, if plaintiffs are alleging that they did not in fact receive any inside information, plaintiffs nonetheless violated the securities laws when they traded on what they believed to be improperly acquired material inside information but did not disclose that information to the other parties to their trades. *See James v. DuBreuil,* 500 F.2d 155, 159-60 (5th Cir. 1974). Plaintiffs' acts fall squarely within the language of Section 10(b) of the Securities Exchange Act, which refers to "any manipulative or deceptive device" and hence encompasses attempted frauds as well as completed frauds. *Kuehnert v. Texstar Corp.,* 412 F.2d 700, 714 (5th Cir. 1969). Plaintiffs' violation of Rule 10b-5 is established, as well, because the Rule extends "to attempted as well as consummated frauds." *Tarasi v. Pittsburgh National Bank,* 555 F.2d 1152, 1159-60 (3rd Cir.), *cert. denied,* 434 U.S. 965 (1977); *Grumet v. Shearson/American Express, Inc.,* 564 F. Supp. 336, 340 (D.N.J. 1983). This is true because subsection (a) of Rule 10b-5 prohibits any "scheme" to defraud, and subsection (c) prohibits any practice that "would operate" as a fraud or deceit. *Grumet v. Shearson/American Express, supra,* 564 F. Supp. at 340.

In determining whether plaintiffs should be barred from suit by the *in pari delicto* defense, it is immaterial in any event whether plaintiffs succeeded in actually violating the securities laws. The controlling factor is that plaintiffs intended to commit fraudulent acts that would have been

[10]Plaintiffs are also liable for securities law violations under a misappropriation theory. *See Chiarella v. United States, supra,* 445 U.S. at 240 (Burger, C. J., dissenting). But under any formulation of the prohibition against insider trading, the objective facts pleaded are sufficient to prevent any claim by plaintiffs that their conduct was benign under the existing *Dirks* standard.

harmful to the securities markets.[11] They may not recover damages simply because their illegal plot was unsuccessful.[12]

[11]The principle that attempts to commit illegal acts equate with successful performance of such acts for purposes of the *in pari delicto* defense is discussed further in Section II A.1 of this brief.

[12]*Cf. Silverberg v. Paine, Webber, Jackson & Curtis, Inc.,* 710 F.2d 678, 691 (11th Cir. 1983) (denying *in pari delicto* defense where broker was not an insider and hence plaintiff inherited no *Chiarella/Dirks* duty to disclose); *Schick v. Steiger,* 583 F. Supp. 841, 847-48 (E.D. Mich. 1984) (denying *in pari delicto* defense on theory that tippees did not acquire duty to disclose from insider who originated tip regarding potential takeover that ultimately failed to materialize); *Xaphes v. Shearson, Hayden, Stone, Inc.,* 508 F. Supp. 882, 886 (S.D. Fla. 1981) (holding that *in pari delicto* defense did not apply to a would-be tippee's Rule 10b-5 claim because broker's customer was not a tippee with a duty to disclose because his broker, who misrepresented to plaintiff customer that he was an insider, in fact was not). The facts in *Xaphes* are distinguishable from the case surrounding Lazzaro's purported tip to plaintiffs here, because the broker here indicated that the "inside" information came from the president or vice-president of the affected corporation and because plaintiffs directly contacted T.O.N.M. president Neadeau in an attempt to verify the information and confirmed with him that the information was "inside" information. (Complaint ¶ 19; Jt. App. 12.) While the broker in *Xaphes* claimed to be an insider as broadly defined (someone with access to material, inside information), *id.* at 884-85 n.3, he did not claim to be and was not a real *Chiarella/Dirks* "insider" with a fiduciary relationship or a "special confidential relationship" with corporate shareholders. *Chiarella, supra,* 445 U.S. at 230, 232; *Dirks, supra,* 103 S. Ct. at 3281 n.14.

The doctrine of "legal impossibility" could provide an absolute defense to a prosecution of plaintiffs in both *Xaphes* and *Silverberg,* because their conduct, even under the facts as they believed them to be, was not unlawful under the securities laws. Petitioner submits that the conclusion of the court in *Schick* that plaintiff there was not liable under *Dirks* was incorrect, however. The court failed to recognize that the tippees had acquired a deriva-

II

THE COMMON LAW DEFENSE OF *IN PARI DELICTO*, BARRING A PLAINTIFF GUILTY OF SUBSTANTIALLY EQUAL FAULT, MAY BE ASSERTED AS A DEFENSE TO PRIVATE ACTIONS IMPLIED FROM FEDERAL SECURITIES LAWS.

A. The Defense of *In Pari Delicto* is a Sound Historical Expression of Policy Protecting the Integrity of the Judicial Process.

1. The Defense Has Been Applied Continuously Since the Earliest Days of Common Law to Bar a Plaintiff Who Has Committed An Unlawful Act or Has Attempted to Do So.

From the earliest days of common law, the courts have refused to aid plaintiffs whose conduct is equally culpable to that of those they seek to sue under the theory that "[h]e who comes here for relief must draw his justice from pure fountains," *Austin's Adm'x v. Winston's Ex'r*, 11 Va. (1 Hen. & M.) 32, 47 (1806). *See, e.g., Creath's Administrator v. Sims*, 45 U.S. 192 (1847); *Holman v. Johnson*, 1 Cowp. 341, 98 Eng. Rpts. 1120 (1775). The roots of this *in pari delicto* doctrine and its application in our legal

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tive duty to disclose from their insurance broker tipper who had received the tip from a close friend who was a member of the founding family of the target corporation. The defendant either derivatively or directly had acquired a duty to disclose from his insider-tipper, and he tipped the plaintiffs for the purpose of financial gain: a rise in the price of the "target" company's stock, a large quantity of which he had purchased himself. *See Dirks*, 103 S. Ct. at 3266. Plaintiffs in *Schick* knew that the "tip" had originated with a corporate insider and that the passage of the tip from corporate insider to insurance broker and from insurance broker to them each breached the respective tipper's fiduciary duty.

system run deep in both English and American decisional law.[13]

The doctrine of *in pari delicto* literally means "of equal fault" and stems from the Latin expression *"in pari delicto potior est conditio defendentis"* ("in a case of mutual fault, the condition of the party defending is the better one"). *Black's Law Dictionary* 711 (rev. 5th ed. 1977). As the doctrine has evolved, the federal courts now require fault to be substantially equal. *See, e.g., Wolfson v. Baker*, 623 F.2d 1074, 1082 (5th Cir. 1980); *James v. DuBreuil*, 500 F.2d 155, 160 (5th Cir. 1974).

Courts have invoked the *in pari delicto* defense in response to a wide variety of unlawful acts, ranging from bribery (*Clark v. United States*, 102 U.S. 181 (1880)) through secret collaboration on a purportedly competitive bid for a public contract (*McMullen v. Hoffman*, 174 U.S. 639 (1898)) to perjury committed to procure homestead lands (*Anderson v. Carkins*, 135 U.S. 483 (1890)). Those cases most pertinent here have involved fraudulent misconduct, which has often provided the basis for application of the defense. *See, e.g., Meguire v. Corwine*, 101 U.S. 108, 111-12 (1880) ("Frauds, of the class to which the one here disclosed belongs, are an unmixed evil. Whether forbidden by a statute or condemned by public policy, the result is the same. No legal right can spring from such a

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[13]The defense was imported from England, where it was articulated by Lord Mansfield as early as 1775 in *Holman v. Johnson*, 98 Eng. Rep. 1120 (1775), and it was firmly implanted in American common law by the end of the nineteenth century, *see St. Louis, Vandalia & Terre Haute R. Co. v. Terre Haute & Indianapolis R. Co.*, 145 U.S. 393 (1801); *Thomas v. City of Richmond*, 79 U.S. (12 Wall.) 349 (1870); *Hannay v. Eve*, 7 J.S. (3 Cranch) 242, 247-49 (1806). Cases construing the defense in the state courts are collected in the petition at 11 n.6.

source."); *McMullen v. Hoffman, supra,* 174 U.S. at 670 ("Being of the opinion that the contract approved in this case was illegal in the sense that it was fraudulent, and entered into for improper purposes, the law will leave the parties as it finds them.").

As might be expected from a defense which focuses upon the immorality of the plaintiff's own conduct, the *in pari delicto* defense is applied both where the plaintiff is guilty of a completed act of malfeasance, *see, e.g., Higgins v. McCrea,* 116 U.S. 671 (1886) (gambling); *Clark v. United States, supra,* 102 U.S. 181 (bribery), and where the plaintiff's misconduct amounts only to an attempt to commit an illegal act, *see, e.g., McMullen v. Hoffman, supra,* 174 U.S. 639; *Scott v. Brown,* 2 Q.B. 724 (1892). The application of the doctrine to an attempt was perhaps first explained in *King v. De Berenger,* 3 Maule & S. 67, 72 (1814) where the court noted that the "purpose [of a conspiracy to raise securities prices] is mischievous" and that the "crime lies in the act of . . . combination to effect that purpose." The court applied the *De Berenger* doctrine in *Scott v. Brown, supra,* to reject a plaintiff's claims that, although he had bought shares at a premium as part of a conspiracy to inflate their market price, he had not committed a wrongful act in making open market purchases. The court centered upon plaintiff's intent and barred his action. 2 Q.B. at 734 (A.L. Smith, L.J.).

This Court adopted the same reasoning when it faced the question in *McMullen v. Hoffman, supra.* This Court there noted, "The vice is inherent in contracts of this kind, and its existence does not in the least depend upon the success which attends the execution of any particular agreement." 174 U.S. 648.

2. The Defense Is Based upon Sound Policy Doctrines of Protection of Judicial Integrity and Deterrence by Denying Rewards to Wrongdoers.

Twin policies of judicial integrity and deterrence have motivated courts from the earliest days of the common law to fashion and to employ the *in pari delicto* defense. Maintenance of judicial integrity requires careful attention to the respectability of the courts, which must not become tainted by facilitating illegal transactions. This wisdom has not been eroded by time; public confidence in the judicial process is surely as imperative today as it ever was.

This policy also seeks to relieve courts from using their increasingly overtaxed resources[14] to sort out relative "justice" among admitted wrongdoers whose complaints stem from their own violations of the law. In *Higgins v. McCrea,* 116 U.S. 671 (1886), this Court implicitly acknowledged that such use of its processes would be hypocritical:

> We do not see on what ground a party who says in his pleading that the money which he seeks to recover was paid out for the accomplishment of a purpose made an offense by the law, and who testifies and insists to the end of his suit that the contract on which he advanced his money was illegal, criminal, and void, can recover it back in a court whose duty it is to give effect to the law which the party admits he intended to violate.

116 U.S. at 685.

The doctrine therefore is applied without regard to individual fairness, resting instead on the societal interest

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[14]"The courts are presently heavily burdened and becoming increasingly so. The scarcity of judicial resources relative to demand of litigants is bordering on the unmanageable. Chief Justice Warren E. Burger, 1984 Year-End Report on the Judiciary (December 31, 1984).

in lawful conduct. As Lord Mansfield wrote in *Holman v. Johnson*, 1 Cowp. 341, 98 England Rpts. 1120 (1775):

> The [*in pari delicto* defense] sounds at all times very ill in the mouth of the defendant. It is not for his sake, however, that the objection is ever allowed; .... The principle of public policy is this; ex dolo malo non oritur actio. (Out of fraud no action arises.).... It is upon that ground the Court goes; not for the sake of the defendant, but because they will not lend their aid to such a plaintiff.

1 Cowp. at 343.

The second policy supporting *in pari delicto*, that of deterrence, was articulated early in this Court's history, in *McMullen v. Hoffman*, 174 U.S. 639 (1898):

> To refuse to grant either party to an illegal contract judicial aid for the enforcement of his alleged rights under it tends strongly towards reducing the number of such transactions to a minimum. The more plainly parties understand that when they enter into contracts of this nature they place themselves outside the protection of the law, so far as that protection consists in aiding them to enforce such contracts, the less inclined will they be to enter into them. In that way the public secures the benefit of a rigid adherence to the law.

174 U.S. at 669-70.

B. Common Law Defenses Such as *In Pari Delicto* Have Been Applied by the Courts of the United States in Securities Actions Since Passage of the Securities Laws.

Common law and equitable defenses are well embedded in the body of decisional securities law. Not only has a plaintiff's willful participation in conduct violating

federal securities laws barred relief on grounds of unclean hands or equal fault,[15] but also plaintiffs have been denied relief on the basis of defenses involving less serious taint such as laches, waiver, estoppel and ratification.[16] As stated in *Royal Air Properties, Inc. v. Smith*, 312 F.2d 210, 213-14 (9th Cir. 1962):

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[15]*See, e.g., James v. DuBreuil*, 500 F.2d 155, 159-60 (5th Cir. 1974) (barring plaintiff's Securities Act Section 12 claim where plaintiff actively participated in fraudulent transaction designed to violate an SEC rule prohibiting inside trading of stock within a certain period of an announced merger); *Gaudiosi v. Mellon*, 269 F. 2d 873 (3d Cir. 1959) (proxy violations barred relief to all plaintiffs where only one plaintiff had unclean hands); *Chris-Craft Industries, Inc. v. Independent Stockholders Committee*, 354 F. Supp. 895 (D. Del. 1973) (unclean hands doctrine applies in private suit for violation of Securities Exchange Commission proxy rules); *Sankin v. 5410 Connecticut Avenue Corporation*, 281 F. Supp. 524 (D.D.C. 1968) (complaint for declaratory relief, accounting and damages dismissed on basis of unclean hands doctrine where complainants had conspired with majority shareholders to defraud minority shareholders), *cert. denied*, 396 U.S. 1041 (1970).

[16]*See, e.g., Dzenits v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 494 F.2d 168, 171-73 (10th Cir. 1974) (court of appeals declined to find laches on the pleadings and remanded to consider defense at trial); *Fey v. Walston & Co.*, 493 F.2d 1036, 1049 (7th Cir. 1974) (defenses of waiver and estoppel available in action under Securities Exchange Act); *Landry v. Hemphill, Noyes & Co.*, 473 F.2d 365, 373-4 (1st Cir.) (plaintiff estopped from claiming he was investor rather than trader with respect to his allegations of churning), *cert. denied*, 414 U.S. 1002 (1973); *Hecht v. Harris, Upham & Co.*, 430 F.2d 1202, 1207-09 (9th Cir. 1970) (laches and estoppel barred plaintiff's claim for damages resulting from alleged churning of account); *Baumel v. Rosen*, 412 F.2d 571, 574-75 (4th Cir. 1969) (adhering to traditional doctrine that action for rescission must be brought without delay), *cert. denied*, 396 U.S. 1037 (1970); *Gordon v. Burr*, 366 F. Supp. 156, 170-71 (S.D.N.Y.

"There is nothing in the language of Section 77*l* [15 U.S.C.] or its legislative history to indicate that Congress intended to create a right enforceable in law or in equity not subject to defenses available at law or in equity to an action based on a voidable contract. The silence of Congress cannot be construed as an intention to make such defenses unavailable."

. . . .

. . . . Since civil liability was judicially implied [under Section 10(b)], the appropriate common law defenses should be applicable. . . . *Since courts generally interpet statutes in the context of the common law and Congress has not specifically denied the availability of these defenses, we see no reason why the ordinary defenses of estoppel and waiver should not be applicable.* The purpose of the Securities Exchange Act is to protect the innocent investor, not one who loses his innocence and then waits to see how his investment turns out before he decides to invoke the provisions of the Act.

Id. at 213-14 (emphasis supplied) (quoting *Straley v. Universal Uranium and Milling Corp.*, 312 F.2d 370, 373-74 (9th Cir. 1962)).

1973) (defense of laches is available to defeat action for rescission of stock sold by fraudulent misrepresentations), *aff'd in part, rev'd in part on other grounds*, 506 F.2d 1080 (2d Cir. 1974); *Walpert v. Bart*, 280 F. Supp. 1006, 1017 (D. Md. 1967) (laches available to bar action for accounting and rescission), *aff'd*, 390 F.2d 877 (4th Cir. 1968); *Tobacco and Allied Stock, Inc. v. Transamerica Corporation*, 143 F. Supp. 323, 327-28 (D. Del. 1956) (defendant allowed to assert laches if circumstances warrant), *aff'd*, 244 F.2d 902 (3d Cir. 1957); *Carr v. Warner*, 137 F. Supp. 611, 614-15 (D. Mass. 1955) (plaintiff's claim barred for failure to complain of facts of which plaintiff was aware).

Until the decision of the Ninth Circuit Court of Appeals below, the courts of appeals that had addressed the question as a matter of law had consistently concluded that when a tippee trades on what he believes to be material non-public information improperly acquired, the *in pari delicto* defense can and should bar the tippee's suit against his purported tipper. *See, e.g., Wolfson v. Baker*, 623 F.2d 1074 (5th Cir. 1980), *cert. denied*, 450 U.S. 966 (1981); *Tarasi v. Pittsburgh National Bank*, 555 F.2d 1152 (3d Cir.), *cert. denied*, 434 U.S. 965 (1977); *Malamphy v. Real-Tex Enterprises, Inc.*, 527 F.2d 978 (4th Cir. 1975); *James v. DuBreuil*, 500 F.2d 155 (5th Cir. 1974); *Kuehnert v. Texstar Corp.*, 412 F.2d 700 (5th Cir. 1969).[17]

Application of these traditional defenses by federal courts has been consistent with this Court's acceptance of

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[17]In addition, most of the district courts which have undertaken a policy analysis and decided the availability of the *in pari delicto* defense under the securities laws in tippee versus tipper lawsuits have refused to permit a tippee to avoid the defense when he trades on what he believes to be material non-public information improperly acquired and then attempts to sue his tipper. *Compare, e.g., Grumet v. Shearson/American Express, Inc.*, 564 F. Supp. 336 (D.N.J. 1983); *Kirkland v. E.F. Hutton and Co., Inc.*, 564 F. Supp. 427 (E.D. Mich. 1983); *In re Haven Industries, Inc.*, 462 F. Supp. 172 (S.D.N.Y. 1978); and *Summerlin v. Blyth, Eastman Dillon & Co.*, [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,197, at 95,787 (N.D. Ga. 1983), which have upheld the availability of the defense, *with Moholt v. Dean Witter Reynolds, Inc.*, 478 F.Supp. 451 (D.D.C. 1979); and *Nathanson v. Weis, Voisin, Cannon, Inc.*, 325 F.Supp. 50 (S.D.N.Y. 1971), the district courts which rejected it. *See also Meredith v. Bear, Stearns & Co.*, [1983-84 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,598, at 97,355 (D.D.C. Dec. 6, 1983) (following *Moholt*).

historic common law and equitable principles[18] unless clearly rendered inapplicable by express statutory language or changed circumstances.[19]

C. Application of the Doctrine of *In Pari Delicto* to Bar Plaintiffs' Claims Implied from the Anti-Fraud Provisions of the Securities Laws is Consistent with the Concepts Articulated in *Perma Life Mufflers, Inc. v. International Parts Corp.*

1. In *Perma Life*, This Court Held That the *In Pari Delicto* Defense Would Not Bar Statutory Antitrust Claims by a Plaintiff Whose Cause of Action Congress Had Elevated Above Common Law Impediments and Whose Fault Was Not Equal to That of the Defendant.

In 1968, this Court addressed the availability of the *in pari delicto* defense to a private treble damage action under the federal antitrust laws in *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134 (1968). Plaintiffs in *Perma Life* were automobile exhaust parts dealers who challenged restrictions that defendant manufacturer in-

[18]This Court and the lower federal courts frequently have returned to the common law as a source of sound principles to guide decisions in cases involving federally-granted rights. *See Briscoe v. LaHue*, 460 U.S. 325, 330-34 (1983) (witness immunity); *Chiarella v. United States*, 445 U.S. 222, 227-29 (1980) (duty of disclosure); *New York Times v. Sullivan*, 376 U.S. 254, 280 (1964) (actual malice).

[19]Even in cases where statutes have explicitly overridden common law principles, this Court has held that such statutes in derogation of common law are to be construed narrowly. *Norfolk Redevelopment and Housing Authority v. C & P Telephone*, 52 U.S.L.W. 4007 (1983); *see Fairfax's Devisee v. Hunter's Lessee*, 11 U.S. (7 Cranch) 603, 623 (1813). Here, of course, plaintiffs have never been able to point to any provision in the securities laws that overrides the common law defense of *in pari delicto* in tippee versus tipper lawsuits.

cluded in its franchise agreements with them. Plaintiffs claimed that defendants had established an illegal price-fixing conspiracy and unlawful tying arrangements.

This Court, in an opinion by Justice Black, concluded that the manufacturer could not assert the *in pari delicto* defense against its dealers.[20] The Court decided that the defense was inapplicable for two reasons, only one of which commanded unequivocal support from a majority of the Court, and neither of which is applicable here. The keystone of Justice Black's opinion for the Court was a dual finding (1) that the Clayton Act's express treble damage "private attorney general" provision evinced Congress' belief that enforcement of national antitrust policy was paramount to otherwise available common law defenses and required maintenance of the private action; and (2) that the plaintiffs there could not be said to be equally responsible for the illegal provisions of the dealership agreement that they challenged.

The first underpinning for Justice Black's opinion for the Court, which was absent from the other four opinions, was that the federal antitrust statutes did not reveal any congressional intent to make the common law *in pari delicto* doctrine a defense to treble damage actions. Citing previous antitrust decisions in which the court had refused to invoke common law defenses, the Court concluded that it would not apply the *in pari delicto* defense to bar claims brought pursuant to the express treble damage private

[20]The case produced five opinions. Chief Justice Warren and Justices Brennan and Douglas concurred in Justice Black's opinion. Justice White wrote an opinion concurring in the opinion of the Court, and Justices Fortas and Marshall each wrote separate opinions concurring in the result. Justice Harlan, joined by Justice Stewart, wrote a fifth opinion concurring in part and dissenting in part.

action provision in the antitrust laws because those laws "encourag[e a plaintiff's] suit to further the overriding public policy in favor of competition." 392 U.S. at 139.[21]

Justice Black's second conclusion was that the facts of the case did not warrant application of the doctrine because plaintiffs' acts fell far short of equal culpability. *Id.* at 139-40.[22] He reserved the question whether "truly complete involvement and participation in a monopolistic scheme would ever be a basis . . . for barring a plaintiff's cause of action." *Id.* at 140.

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[21]It might be argued that in considering whether the defense would frustrate an antitrust statute specifically designed to protect the plaintiffs from the conduct complained of, the Court was reasoning along the lines of an historic common law exception to the *in pari delicto* doctrine.

Courts at common law would not apply the *in pari delicto* defense to bar claims of a plaintiff for whose protection the law that made plaintiff's action illegal was enacted. *See, e.g., A. C. Frost & Co. v. Coeur d'Alene Mines Corp.*, 312 U.S. 38 (1941) (plaintiff entitled to prevail on common count for money had and received based upon breach of an option agreement to sell stock which was unregistered); *Smith v. Bromley*, 99 Eng. Rep. 441 (1760) (Lord Mansfield) (plaintiff allowed to recover payment made to induce defendant creditor to sign bankruptcy certificate because law violated was designed to protect plaintiff from oppression, extortion, or deceit).

[22]This Court clearly felt that plaintiffs' illegal acts had been coerced. *See, e.g., id.* at 139 ("[T]heir participation was not voluntary in any meaningful sense. They sought the franchises enthusiastically but they did not actively seek each and every clause of the agreement. Rather, many of the clauses were quite clearly detrimental to their interests, and they alleged that they had continually objected to them. Petitioners apparently accepted many of these restraints solely because their acquiescence was necessary to obtain an otherwise attractive business opportunity.").

An exception to the *in pari delicto* defense for "economic coercion" can be traced to this Court's early decisions considering the defense. This Court noted in *Sample v. Barnes*, 55 U.S. (14 How.) 70 (1852):

> [I]f one party acts under oppression, imposition, hardship, undue influence, or great inequality of age or condition,

Chief Justice Warren and Justices Brennan, Douglas and White joined Justice Black's opinion; but Justice White wrote a separate concurrence to emphasize his view that the defense should apply where plaintiff and defendant are substantially equally responsible for the violation (*id.* at 146) (White, J., concurring), and four additional justices shared that view, in three separate opinions. Justice White wrote:

> Generally speaking, however, I would deny recovery where plaintiff and defendant bear substantially equal responsibility for injury resulting to one of them but permit recovery in favor of the one less responsible where one is more responsible than the other.[23]

> although he may be in delicto, he is not in pari delicto, and may have relief in equity. 1 Story, Eq. Jur. sec. 300; *Osborne v. Williams*, 18 Ves. 379; *Phalen v. Clark*, 19 Conn. 421; *Pinckston v. Brown*, 3 Jones (N.C.) Eq. 494; *Freelove v. Cole*, 41 Barb. 318; *Goodenough v. Spencer*, 15 Abb. Pr. N.S. 248; 46 How. Pr. 347; 2 Thomp. & C. 508.

55 U.S. at 71. The coercion theory became an important part of antitrust case law in *Ring v. Spina*, 148 F.2d 647 (2d Cir. 1945), where the court refused to apply the *in pari delicto* defense against a plaintiff drama producer who had been economically coerced into signing the Dramatist Guild's Minimum Basic Agreement, which fixes terms under which Guild members license or sell their works. The court explained:

> [P]laintiff is precisely the type of individual whom the Sherman Act seeks to protect from combinations fashioned by others and offered to such individual as the only feasible method by which he may do business. Considerations of public policy demand court intervention in behalf of such a person, even if technically he could be considered in pari delicto . . . . Any other conclusion would mean that for many, perhaps most victims of restraint of trade, private remedies under the Sherman Act would be illusory if not quite non-existent.

Ring v. Spina, 148 F.2d 647, 653.

[23]The analysis was presented in terms of relative causation of injury, but the concept of equality of fault appeared to be the critical factor, as in other applications of the *in pari delicto* defense.

Id. (White, J., concurring).

Concurring in the result only, Justice Fortas wrote:

> If the fault of the parties is reasonably within the same scale — if the *"delictum"* is approximately *"par"* — then the doctrine should bar recovery.

Id. at 147 (Fortas, J., concurring in result).

Justice Marshall wrote separately to endorse a similar view:

> I believe that a limited application of the basic principle behind the doctrine of *in pari delicto* is both proper and desirable in the antitrust field. As the Court notes, *ante,* at 138, the literal meaning of *in pari delicto* is of equal fault. I would hold that where a defendant in a private antitrust suit can show that the plaintiff actively participated in the formation and implementation of an illegal scheme, and is substantially equally at fault, the plaintiff should be barred from imposing liability on the defendant.

Id. at 149 (Marshall, J., concurring in result).

Justice Marshall went on to state:

> . . . I cannot agree that the public interest requires that a plaintiff who has actively brought about illegal restraints on competition for his own benefit be permitted to demand redress — in the form of treble damages — from a partner who is no more responsible for the existence of the illegality than the plaintiff.

Id. at 151.

Finally, Justice Harlan, concurring in part and dissenting in part in an opinion joined by Justice Stewart, stated as follows:

> I would remand this case to determine whether any agreement alleged to be in restraint of trade was one for which the plaintiffs were substantially as much responsible, and as much legally liable, as the defendants.

Id. at 156 (Harlan, J., concurring in part and dissenting in part).

A majority of five justices of this Court thus agreed that a plaintiff's culpability should serve as a defense to even a statutory private antitrust action in circumstances where the plaintiff's conduct was substantially equal in culpability to the defendant's. This relative equality of fault, which is an essential predicate to availability of the *in pari delicto* defense, and which this Court determined was absent in *Perma Life,* is present here.

2. No Intent of Congress to Bar Common Law Defenses Such as *In Pari Delicto* May Be Divined from the Securities Laws Upon Which Plaintiffs Rely.

There are crucial distinctions between the antitrust statutes considered in the *Perma Life* decision and the securities laws upon which plaintiffs rely here. Congress in the antitrust laws explicitly provided for private actions with treble damage penalties to foster private enforcement of competition laws. Clayton Act § 4, 15 U.S.C. § 15 (West 1973 & Supp. 1984), formerly Sherman Act § 7. Such private actions did not exist at common law to redress unfair competition. *See* 1 E. Kintner, Legislative History of Antitrust Statutes 34 (1983 ed.); 1 J. von Kalinowski, Antitrust Laws and Trade Regulation § 1.02[4] at 35-36 (1984 ed.) ("At common law, contracts in restraint of trade and combinations to monopolize were not unlawful in the sense of being criminal, nor did their existence give rise to a civil action.")[24]

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[24]Thus, while a contract that unreasonably restrained trade was void and unenforceable at common law, such a contract did not

The treble damage and attorneys' fee provisions in the antitrust laws obviously reflect Congress' desire to go beyond the common law in the antitrust statute in order to provide substantial encouragement to private enforcement and to help deter anticompetitive conduct.[25] In the securities laws, by contrast, the Congress failed to provide an express private right of action for securities fraud under Section 10 of the Securities Exchange Act or Section 17 of the Securities Act, leaving a remedy for violation of those sections either non-existent or to be implied from language couched in terms similar to the elements of common law fraud.

Moreover, in the Insider Trading Sanctions Act of 1984 (the "Act"), the Congress only recently expressly provided treble penalty provisions, but only in enforcement proceedings by the SEC, and only against any purchaser or seller who trades on material non-public information in violation of the Securities Exchange Act. Insider Trading Sanctions Act, § 2, 1984 U.S. Code Cong. & Ad. News (98 Stat.) 1264 (to be codified at 15 U.S.C. § 78u(d)(2)) (Brief App. at A-2-A-6). Congress clearly did not see any national policy

afford an injured party an opportunity to sue for damages or injunctive relief. *See United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 279 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899) (Sherman Act created private right of action for damages and/or injunctive relief that was previously unavailable); *State v. Duluth Board of Trade*, 107 Minn. 506, 121 N.W. 395, 404 (1909) (contract in restraint of trade simply unenforceable); *see also Mogul Steamship Co., Ltd. v. Mcgregor, Gow & Co.*, 1892 A.C. 25 (no damages action for restraint of trade at common law).

[25]The legislative history confirms that this was Congress' intent. *See* 21 Cong. Rec. 2569, 3147, *reprinted in* 1 E. Kintner, The Legislature History of the Federal Antitrust Laws and Related Statutes ("Legislative History") 177, 283 (1978) (remarks of Senator Sherman, Senator Reagan); *id.* at 34 ("The original section 7 of the [Sherman Antitrust] Act (now found in section 4 of the Clayton Act, as modified) was of primary importance in that it created a private right of action not present under common law whereby any person

requiring special assistance from private litigants in enforcing bans on insider trading.[26]

The implied right of action under Rule 10b-5 thus is a product of implication from a statute utilizing language consistent with intentional fraud rather than negligence or strict liability. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197-201 (1976). This Court has stated that it acknowledged that right of action for damages under Section 10(b) of the Securities Exchange Act because of nearly four decades of decisions implying this remedy (*Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 (1983)), which began with the application of common law principles to a securities law fraud violation in *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 514 (E.D.Pa. 1946).[27] The court held in *Kardon* that the right to recover damages arising from fraudulent

"injured in his business or property" by reason of any violation of the Act is entitled to sue for treble the damages sustained including the cost of suit and a reasonable attorney's fee.").

The remedial section of the bill was modified during the consideration of the various versions of the Sherman Act. The Senate Judiciary Committee increased the recoverable damages from double to treble. *Compare* S. 1, § 2, as printed March 26, 1890, *reprinted in* Legislative History at 257-58 *with* S. 1, § 7, as reported April 2, 1890, *reprinted in* Legislative History at 277.

[26]The legislative history of the Insider Trading Sanctions Act reveals that the SEC never suggested and the Congress never even considered creating private actions as part of the Act or making the treble damage penalties available in any private actions that may already exist. Instead, the focus of the legislative proceedings was on the SEC's need for an additional remedy to employ in connection with the *existing* SEC enforcement provisions, in order to create a greater disincentive for those who actually *trade* on insider information. *See, e.g., Hearing on H.R. 559 Before the Subcommittee on Securities of the Senate Committee on Banking, Housing, and Urban Affairs*, 98th Cong., 2d Sess. 14 (April 3, 1984) (Statement of The Honorable John S. R. Shad, Chairman, SEC).

[27]*See also Merrill Lynch, Pierce, Fenner & Smith v. Curran, Inc.*, 456 U.S. 353, 379 (1982) (affirming existence of an implied action

conduct described in Section 10(b) and Rule 10b-5 "is so fundamental and so deeply ingrained in the law that where it is not expressly denied the intention to withhold it should appear very clearly and plainly." *Id.* at 514. A private right of action under Section 17(a) of the Securities Act, as alleged here, must be implied by the same route, if such a right exists at all.[28]

If, as noted above, this Court has acquiesced in the recognition of certain implied private rights of action in part because they were long recognized by lower courts and not disturbed by the Congress, then equally this Court should not disturb the long-time recognition of *in pari delic-*

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under the Commodity Exchange Act, 7 U.S.C. § 1 *et seq.*, in part because of Congressional acquiescence in the courts implication of the right); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 733 (1975) (refusing to extend 10b-5 actions beyond actual purchasers or sellers, in part because of Congress' failure to reject the courts' limitation to that effect).

[28]A conflict appears to exist among the circuits that have decided this question, but a comparison of those cases which allow for a private right of action under § 17(a) with those cases which do not reveals that since the decisions of this Court in *Touche Ross & Co. v. Redington, Trustee*, 442 U.S. 560 (1979), and *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11 (1979), most courts have been disinclined to find an implied private right of action. *See e.g.*, the following cases determining that no private right of action exists under Section 17(a): *Keys v. Wolfe*, 709 F.2d 413, 416 (5th Cir. 1983); *Simpson v. Southeastern Investment Trust*, 697 F.2d 1257, 1258 (5th Cir. 1983); *Shull v. Dain, Kalman & Quail, Inc.*, 561 F.2d 152, 155, 159 (8th Cir. 1977). *Compare, e.g.*, the following decisions which have allowed a private right of action under § 17(a): *Newman v. Prior*, 518 F.2d 97, 99 (4th Cir. 1975); *Stephenson v. Calpine Conifers II, Ltd.*, 652 F.2d 808, 815 (9th Cir. 1981).

This Court does not need to decide the availability of a private action under Section 17 now, because regardless of the decision, there is no reason to consider the *in pari delicto* defense differently depending on whether the claim is a Section 17(a) or a Section 10(b) claim. Indeed, because a Section 17(a) private right of

to in securities fraud cases. It is appropriate to assume both Congress' awareness of the well-established existence of common law defenses when it enacted the Securities Act in 1933 and the Securities Exchange Act in 1934 and its awareness of the courts' application of common law defenses to securities law fraud claims during the intervening years prior to the passage of the Insider Trading Sanctions Act of 1984. *See Merrill Lynch, Pierce, Fenner & Smith v. Curran*, 456 U.S. 353, 379 (1982), (quoting *Cannon v. University of Chicago*, 441 U.S. 677, 696-97 (1979) ("It is always appropriate to assume that our elected representatives, like other citizens, know the law. . . .")).

Indeed, Congress even included savings clauses in the Securities Act and Securities Exchange Act to leave no room for doubt as to its intentions. Those savings clauses state that "[t]he rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity." Section 16 of the Securities Act; Section 28 of the Securities Exchange Act. In contrast, neither the Sherman Act nor the Clayton Act contains a "savings clause" preserving common law rights and remedies. Sherman Antitrust Act, 26 Stat. 209 (1890), *codified at* 15 U.S.C.A. § 1 *et seq.* (West 1973 & Supp. 1984); Clayton Act, 38 Stat. 731, 15 U.S.C. § 12 *et seq.* (West 1973 & Supp. 1984).

In its amicus brief to the court of appeals below, the SEC argued from its prosecutorial perspective that elimination of the common law *in pari delicto* defense where a broker is a defendant would aid in the enforcement of the securities

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action, if one were held to exist, would have to be judicially implied just as a Rule 10b-5 claim has been, it necessarily would be equally subject to common law defenses. A number of district courts, including the district court below, have concluded that the defense applies to Section 17(a) claims. *See In re Haven Industries, Inc.*, 462 F. Supp. 172, 181 (S.D.N.Y. 1978); *Jackson v. Oppenheim*, 411 F. Supp. 659, 665 (S.D.N.Y. 1974).

laws. The Commission noted that it "strongly agrees that illegal tippee trading poses a serious threat to the investing public," Brief of SEC at 15, and advised the court that it was therefore supporting legislation, now enacted as the Insider Trading Sanctions Act, to reduce such activity. Yet neither the language nor the two-year legislative history of that Act[29] supports the supposed need for private civil tippee versus tipper actions as an essential law enforcement tool against insider trading.

Furthermore, the SEC's utilitarian arguments regarding deterrence do not withstand analysis in light of logic and relevant provisions of the securities laws, as the Third, Fourth and Fifth Circuit Courts of Appeals have concluded and as most district courts have agreed. *See, e.g., Tarasi v. Pittsburgh National Bank,* 555 F.2d 1152 (3d Cir.), *cert. denied,* 434 U.S. 965 (1977); *Malamphy v. Real-Tex Enterprises, Inc.,* 527 F.2d 978 (4th Cir. 1975); *Kuehnert v. Texstar Corp.,* 412 F.2d 700 (5th Cir. 1969); *Grumet v. Shearson/American Express, Inc.,* 564 F.Supp. 336 (D.N.J. 1983); *Kirkland v. E.F. Hutton and Co., Inc.,* 564 F. Supp. 427 (E.D. Mich. 1983); *In re Haven Industries, Inc.,* 462 F. Supp. 172 (S.D.N.Y. 1978); *Summerlin v. Blyth, Eastman Dillon & Co.,* [1982-83 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,197 (N.D. Ga. 1983).

Rejection of the *in pari delicto* defense in the name of protecting the public interest under the securities laws would disserve the very policies the securities laws purport to guard. The Third Circuit Court of Appeals in *Tarasi v. Pittsburgh National Bank, supra,* 555 F.2d 1152, assessed the policy question as follows:

> [P]ermitting *in pari delicto* could have a more telling effect on "tippee" conduct. As Judge Aldrich noted in *Kuehnert,* the danger of eliminating *in pari delicto* is that such a stance would give "tippees" almost no incentive to forebear from using inside information. This is so since if the suggested purchase proved unprofitable, the "tippee" might have recourse against his "tipper" on account of the inaccurate leak. The threat of application of *in pari delicto* would eliminate the warranty of the accuracy of the tip that might otherwise exist.
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> Moreover, . . . as *Kuehnert* pointed out, substantial deterrents to "tippers" are provided by the possibility of SEC and criminal actions and private suits by non-"tippee" purchasers and sellers who have been adversely affected by the dissemination of inside information.

Id. at 1163-64 (footnotes omitted).

Unlike the SEC's and plaintiffs' arguments regarding the deterrent effect of eliminating the *in pari delicto* defense, the deterrents to tippers referenced in *Tarasi* are not hypothetical but instead are statutory. A securities broker-dealer is a highly visible[30] and vulnerable member of a

[29]See footnote 26, *supra.*

[30]The court in *In re Haven Industries, Inc.,* 462 F. Supp. 172 (S.D.N.Y. 1978) noted this visibility:

> Although the "tippee" is then potentially liable to his vendors or vendees for violating Rule 10b-5, his remoteness from the insider group may, as a practical matter, make it difficult to discover him and thus effectively insulate him from liability. By contrast, substantial deterrents to "tippers" would remain in the form of SEC and criminal actions as well as private suits by non-"tippee" purchasers and sellers who have been adversely affected by the selective disclosure of inside information . . . .
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> . . . . Elimination of the defense would remove the most effective disincentive against the "tippee's" use of inside information. Because of the tippee's relatively low visibility, the threat of discovery and potential liability is slight. By contrast, "tippers" are usually highly visible officers, directors or brokerage firms, subject to extensive statutory disclosure requirements, SEC enforcement actions and private suits by non-"tippee" purchasers or sellers.

462 F. Supp. at 180.

regulated industry. Thus, a broker-dealer who disseminates material inside information or who, as claimed by plaintiffs, disseminates false information in violation of the securities laws is subject to various enforcement remedies of the Securities and Exchange Commission.[31] Furthermore, a broker-dealer in such circumstances also is subject to discipline, suspension or expulsion from the stock exchanges or other self-regulatory entities through which it does business.[32]

The Fifth Circuit Court of Appeals recognized that insider trading will be encouraged if the *in pari delicto* defense is eliminated, in *Kuehnert v. Texstar Corp.*, 412 F.2d 700 (5th Cir. 1969). The court reasoned that the most effective way to deter tippees from trading on what they believe to be inside information is to remove the tippee's guarantee

[31]*See, e.g.*, 15 U.S.C. § 77t(b) (Commission may bring action for injunction or criminal prosecution for violations of Securities Act); 15 U.S.C. § 78o(b)(4)-(6) (Commission may bring administrative proceedings against broker-dealer seeking censure, limitations on activities and suspension or revocation of registration of broker-dealer or person associated with broker-dealer); 15 U.S.C. § 78u(a) (Commission may investigate and issue report of such investigations whenever person has violated, is violating or is about to violate Securities Exchange Act, its rules or regulations thereunder, rules of national securities exchange or registered securities association of which such person is member, rules of registered clearing agency in which such person is participant, or rules of Municipal Securities Rulemaking Board); 15 U.S.C. § 78u(d) (Commission may bring action to enjoin violations of Securities Exchange Act, its rules or regulations thereunder, rules of national securities exchange or registered securities association of which such person is member, or rules of registered clearing agency in which such person is participant).

[32]*See, e.g.*, Article XIV of the Constitution of the New York Stock Exchange and the rules promulgated thereunder; Article V of the Constitution of the American Stock Exchange and the rules promulgated thereunder; Rule IV of the Rules of Fair Practice of the National Association of Securities Dealers. *See also* 15 U.S.C. § 78o-3(g); 15 U.S.C. § 78s(d)-(f).

and to allocate the risk of financial loss upon the tippee-trader in the event of a false tip:

> If a tippee can sue he has, in effect, an enforceable warranty that secret information is true. It is then that he will have free rein. If what he is told is false, he can recover against his informer. If it is true, he will, of course, be liable to his vendors or vendees, but here he may well be protected by the difficulties of discovery. It may be relatively easy to trace insiders; tippees are another matter.
>
> The growth of 10b-5 actions has not thus far been handicapped observably by the absence of suits by tippees against insiders. Nor do we believe that *in pari delicto* and unclean hands have limited the effectiveness of the proxy regulations. Therefore, in view of the substantial deterrent pressures already felt by the corporate insider, *SEC v. Texas Gulf Sulphur Co.*, [401 F.2d 833 (2nd Cir. 1968), *cert. denied sub nom, Coates v. SEC,* 394 U.S. 976 (1969)], we think it important that tippees, who present the same threat to the investing public as do insiders themselves, should be offered appropriate discouragement. We conclude that the better choice is to leave upon persons believing themselves tippees the restraint arising from the fear of irretrievable loss should they act upon a tip which proves to have been untrue. Hence the loss must lie where it falls.

412 F.2d at 705 (footnotes omitted).[33]

[33]As was recognized in *Wohl v. Blair & Co.*, 50 F.R.D. 89 (S.D.N.Y. 1970), the more effective technique for halting future trading on inside information is to allocate the risk of financial loss on the tippee-trader, and make him aware that his investment could well be lost:

> [I]t may well be that much of the excessive and inflationary speculation in securities is attributable to customers seeking

Justices White and Marshall voiced these same concerns in the antitrust context in their concurring opinions in *Perma Life*:

> In the third case, [of a conspiracy to set prices among D & E] where D and E are competitors, if D simply proves the agreement and the resulting loss, should he recover from E, absent some believable showing that E was the more responsible for the illegal scheme? No doubt E was a substantial factor in the combination and hence in the injury; a judgment for damages might deter him and others from violating the law. But D is equally responsible for his own damages. To permit him a recovery may be a counterdeterrent.

392 U.S. at 146 (White, J., concurring).

> The possible added deterrence to violations of the antitrust laws that would be produced by the Court's holding [limiting the defense in antitrust actions] may well be equaled, if not surpassed, by the new incentive it will create to commit such violations, for a potential violator will have less to lose if he can attempt to recover his losses from his partner should the scheme not work out to his benefit.

Id. at 151 (Marshall, J., concurring in result).

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information which they are not entitled to unless and until it is freely available to all. One possible solution may be the adoption of a form of "*caveat tippee*" policy. If such customers learn that they accept "inside information" at their own risk, many may decide that it is better to reject proffers of such information and to play the game according to the laws and SEC rules enacted for their protection than to risk loss of their hard-earned capital.

50 F.R.D. at 93.

This identical rationale echoes through decisions of other courts faced with the question of who should bear the risk of loss in tippee versus tipper civil litigation.[34] *See, e.g., In re Haven Industries, Inc.*, 462 F. Supp. 172, 179-80 (S.D.N.Y. 1978) ("[E]limination of the *in pari delicto* defense eliminates any incentive for the 'tippee' to refrain from using inside information .... [because] [i]f what has been disclosed is false, he can recover against the tipper; if the inside information is true, he is virtually certain to make an illegal profit"); *Wolfson v. Baker*, 623 F.2d 1074, 1082 (5th Cir. 1980) ("Any deterrent effect of threatened liability on the broker may well be more than offset by the inducement to violations inherent in the prospect of a free ride for the customer who . . . is placed in the enviable position of 'heads-I-win tails-you-lose' " (quoting *Pearlstein v. Scudder & German*, 429 F.2d 1136, 1148 (2d Cir. 1970) (Friendly, J., dissenting), *cert. denied*, 401 U.S. 1013 (1971)), *cert. denied*, 450 U.S. 966 (1981).

Thus, as these courts have recognized, the tippee could trade with impunity if the defense were unavailable. If the information were intentionally false, he could sue his broker or officer tipper to recover his losses or his expected profits. If the information proved true, he could reap a bonanza. A decision upholding the result reached by the

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[34]The Ninth Circuit Court of Appeals rejected this critique of the elimination of the defense, concluding that a purported tippee does not have a "warranty of accuracy" because he could not sue his tipper if his tipper did not have an "intent to deceive, manipulate or defraud." (730 F.2d at 1324 n. 3, quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976)). That analysis cannot justify elimination of the defense, however, because it overlooks the effect of that elimination: permitting resort to the courts by those who intentionally violated the securities laws in transactions with sellers of securities who were entirely blameless.

Ninth Circuit Court of Appeals accordingly would foster the very insider trading that Congress has just attempted to reduce.

Plaintiffs' claims under Sections 10 and 17 are, after all, comparable to fraud claims arising under the laws of any common law jurisdiction prohibiting willful fraudulent conduct. This historic teaching of these jurisdictions that barring relief to wrongdoers deters fraud does not lose its force because securities fraud laws are at issue.

Yet even if plaintiffs' and the SEC's position below were correct, the defense should still apply. That a particular result will advance the SEC's prosecutorial goals, however laudatory they may be, is simply insufficient to mandate the result the SEC seeks when the statutory and decisional law do not support it.[35] This conclusion takes on even greater

[35]*See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), where this Court refused the SEC's request that it extend Section 10(b) of the Exchange Act and Rule 10b-5 beyond actual purchasers and sellers despite the literal language of the section and rule. Justice Powell, joined by Justices Stewart and Marshall, wrote:

> The courts already have inferred a private cause of action that was not authorized by the legislation. In doing this, however, it was unnecessary to rewrite the precise language of § 10(b) and Rule 10b-5. This is exactly what respondent – joined, surprisingly, by the SEC – sought in this case. If such a far-reaching change is to be made, with unpredictable consequences for the process of raising capital so necessary to our economic well-being, it is a matter for the Congress, not the courts.

Id. at 759-60 (Powell, J., concurring).

Absent a legislative action to the contrary, which has not occurred here, this Court repeatedly has refused to accede to such requests that it advance prosecutorial aims. Thus, this Court in *Chiarella v. United States*, 445 U.S. 222 (1980), and *Dirks v. SEC*, — U.S.—, 103 S.Ct. 3255 (1983), refused to find violations of securities laws in connection with insider trading in situations where the securities laws incorporating common law principles failed to create a duty applicable to the defendants. *Dirks, supra*, 103 S.Ct. at 3261, 3268; *Chiarella*, 445 U.S. at 227-28, 236-37.

force in light of the fact, established in Section II.A.2., that a principal purpose of the *in pari delicto* defense is to preserve and protect the integrity of the courts. Courts barring claims by tippees have so recognized.[36]

III

PLAINTIFFS' CONDUCT ADMITTED IN THEIR COMPLAINT IS MORE THAN SUFFICIENTLY WRONGFUL TO BAR THEIR CLAIMS FOR RELIEF.

The SEC in its amicus brief to the Ninth Circuit Court of Appeals conceded that the *in pari delicto* doctrine should bar a plaintiff tippee's claims when the parties are equally at fault. Brief of SEC at 6. Actually, the proper standard is *substantial* equality of fault because confessed, purposeful transgressors are not entitled to insist upon fine distinctions of blame. Plaintiffs admit that they intentionally and repeatedly traded on what they knew to be improperly obtained inside information, although they allege that some of that information later proved false or incomplete. As explained in full in Section I, above, plaintiffs' allegations establish their own violations of the securities fraud provisions under this Court's decisions in *Dirks v. SEC* and

[36]The affront to a court's integrity that would result from entertaining the damage claims of a tippee whose greedy trading did not yield the results he planned was recognized in *Tarasi v. Pittsburgh Nat'l Bank, supra*, where the Third Circuit Court of Appeals noted in affirming application of the defense:

> [W]e believe it not improper to take into consideration the factors that form the basis of *in pari delicto:* augmenting the integrity of the courts and preventing wrongdoers from profiting from their misdeeds.

555 F.2d at 1164. *See also James v. DuBreuil*, 500 F.2d 155, 160 (5th Cir. 1974) ("If plaintiff was duped in the process, it is not our role to serve as referee in an accounting between two coconspirators"); *Kirkland v. E. F. Hutton and Co., Inc.*, 564 F. Supp. 427, 436 (E.D. Mich. 1983) ("[T]he interest in preserving the integrity of the courts by denying recourse to those who are as blameworthy as those from whom they seek to recover, lead[s] me to conclude that the defense is applicable. . . .").

Chiarella v. United States. There is nothing in the securities laws which warrants a greater tenderness toward tippees who defraud the investing public than toward alleged tippers. Because the culpability and the immoral purpose of the tippee-plaintiffs and of the alleged tipper was at least substantially equal according to the allegations of the complaint, the "fault" of the parties under the securities laws therefore is also at least equal.

Yet the SEC's amicus brief below argues that even though the *in pari delicto* defense is applicable to securities fraud claims, it should almost never be allowed where the defendant is a broker-dealer. This suggestion ignores the language of the involved provisions, which each proscribe fraudulent conduct by "any person." The argument also disregards the high level of culpability of the trading tippee, and it fails entirely to recognize the dynamics of the harm to the market that trading on inside information causes.

The federal securities statutes and rule at issue here, Securities Act Section 17(a), Securities Exchange Act Section 10(b) and Rule 10b-5, govern the rights and duties of *all* investors, not just securities professionals, when they explicitly set one standard for all by proscribing fraudulent conduct by "any person."[37] These provisions do *not* limit their application only to conduct by brokers and corporate officers, nor do they impose any hierarchy of guilt or liabil-

[37]Indeed, the "any person" language was never varied at any time from the date of the introduction of the Securities Exchange Act in the Senate on April 17, 1934, S. 3420, 73d Cong., 2d Sess., through the introduction of a similar bill in the House on April 25, 1934, H.R. 9323, 73d Cong., 2d Sess., through the Conference Report to accompany H.R. 9323, Conf. Rep. 1838, 73d Cong., 2d Sess., May 31, 1934, *all reprinted in* 1 Federal Securities Laws Legislative History 1933-1982, at 650, 755, 1169, 1179 (1983). The same is true for the history of what ultimately became Section 17(a). *See* S. 875, 73d Cong, 1st Sess., introduced March 29, 1933; H.R. 5480, 73d Cong., 1st Sess., introduced May 3, 1933; Conference Report to accompany H.R. 5480, Conf. Rep. No. 152, 73d Cong., 1st Sess., May 20, 1933, *all reprinted in* 1 Federal Securities Laws Legislative History 1933-1982, *supra*, at 27, 99, 252.

ity. But if a hierarchy of culpability were to be created, the tippee, without whose trades no harm would occur, would be the more guilty party.

Counsel for petitioners have not uncovered any basis in the language or history of any provisions of the federal securities laws applicable to both brokers and traders that would impose a higher duty to the market on securities professionals by virtue of their professional status. To the contrary, in *Dirks v. SEC* this Court described as "novel" the suggestion that broker-dealers operate under a special duty to the general public by virtue of their status. 103 S. Ct. at 3255.

The dichotomy suggested by the SEC and drawn in the Ninth Circuit Court of Appeals' opinion is all the more inappropriate because it shields the very persons who are directly causing the damage to the market that the Congress enacted the Securities and Securities Exchange Acts to prevent. A broker's dissemination of false information about a company does not alter the price of that company's stock or otherwise harm its holders or sellers. But the tippee who trades in the stock, thinking he has an informational advantage over the innocent investor, directly causes an adverse impact on the market. This is precisely what the Congress sought to eliminate by the Securities Exchange Act, one purpose of which is "to assure that dealing in securities is fair and without undue preferences or advantages among investors." Conf. Rep. No. 229, 94th Cong., 1st Sess., May 19, 1975, *reprinted in* 3 Federal Securities Laws Legislative History 1933-1982, at 3041, 3128 (1983). Tippees thus harm the market as much as, if not more than, their tipper and corporate insider do.

Moreover, by definition a tippee who trades on what he believes to be inside information without disclosing it to the other party to his trade acts with scienter, just as does a tipper who knowingly disseminates false inside information.

The Third Circuit Court of Appeals addressed the concept of equal responsibility with insight in *Tarasi v. Pittsburgh National Bank, supra*, 555 F.2d at 1162:

> [T]his litigation contains an important element, absent in *Perma Life,* that, we believe, makes it an instance of joint participation in wrong-doing — specifically, voluntary illegal conduct on the part of the plaintiffs.
>
> *Perma Life* emphasized the fact that the participation by the plaintiffs in the unlawful agreement was passive, and perhaps coerced. . . .
>
> The fact that the plaintiffs in this case willingly committed illegal acts would seem to obviate these concerns to a substantial degree. . . . Moreover, it should be noted that the voluntary illegal activities of the plaintiffs present a serious threat to the investing public, which the securities laws seek to prevent. Finally, the voluntary acts of the plaintiffs may fairly be said to be a sine qua non of their losses; but for their purchases of Meridian securities, they would not have suffered any injury.

Id. at 1162 (footnote omitted).

Legally and factually, this substantially equal culpability and responsibility of plaintiffs renders the *in pari delicto* defense applicable to bar plaintiffs' claims.

CONCLUSION

This Court should reverse the judgment of the United States Court of Appeals for the Ninth Circuit and enter a judgment dismissing this action and holding that plaintiffs' implied securities fraud claims are barred by the *in pari delicto* defense, based on their admitted violations of the very statutes they seek to assert against defendant and petitioner BEHR. This result will confirm and promote the sound public policies of judicial integrity and deterrence underlying the defense.

Respectfully submitted,

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Brief Appendix A — Statutory Provisions Involved

Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a) (1982), states:

> (a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly —
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b) (1982), states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —
>
> . . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Securities Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 (1985), states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (1) to employ any device, scheme, or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

The Insider Trading Sanctions Act, 1984 U.S. Code Cong. & Ad. News (98 Stat.) 1264, to be codified at Section 21(d) of the Securities Exchange Act, 15 U.S.C. § 78u(d), states:

> SECTION 1. This Act may be cited as the "Insider Trading Sanctions Act of 1984."
>
> SEC. 2. Section 21 of the Securities Exchange Act of 1934 is amended by redesignating subsection (d) as subsection (d)(1), and adding at the end thereof the following new paragraph:
>
> "2(A) Whenever it shall appear to the Commission that any person has violated any provision of this title or the rules or regulations thereunder by purchasing or selling a security while in possession of material non-public information in a transaction (i) on or through the facilities of a national securities

> exchange or from or through a broker or dealer, and (ii) which is not part of a public offering by an issuer of securities other than standardized options, *the Commission may bring an action in a United States district court to seek*, and the court shall have jurisdiction to impose, *a civil penalty* to be paid by such person, or any person aiding and abetting the violation of such person. The amount of such penalty shall be determined by the court in light of the facts and circumstances, but shall not exceed three times the profit gained or loss avoided as a result of such unlawful purchase or sale, and shall be payable into the Treasury of the United States. If a person upon whom such a penalty is imposed shall fail to pay such penalty within the time prescribed in the court's order, the Commission shall refer the matter to the Attorney General who shall recover such penalty by action in the appropriate United States district court. The actions authorized by this paragraph may be brought in addition to any other actions that the Commission or the Attorney General are entitled to bring. For purposes of Section 27 of this title, actions under this paragraph shall be actions to enforce a liability or a duty created by this title. The Commission, by rule or regulation, may exempt from the provisions of this paragraph any class of persons or transactions.
>
> "(B) No person shall be subject to a sanction under subparagraph (A) of this paragraph solely because that person aided and abetted a transaction covered by such sub-paragraph in a manner other than by communicating material non-public information. Section 20(a) of this title shall not apply to an action brought under this paragraph. No person shall be liable under this paragraph solely by reason of em-

ploying another person who is liable under this paragraph.

"(C) For purposes of this paragraph profit gained or loss avoided is the difference between the purchase or sale price of the security and the value of that security as measured by the trading price of the security a reasonable period after public dissemination of the non-public information.

"(D) No action may be brought under this paragraph more than five years after the date of the purchase or sale. This paragraph shall not be construed to bar or limit in any manner any action by the Commission or the Attorney General under any other provision of this title, nor shall it bar or limit in any manner any action to recover penalties, or to seek any other order regarding penalties, imposed in an action commenced within five years of such transaction."

SEC. 3. Section 32 of the Securities Exchange Act of 1934 is amended by striking "$10,000" from subsection (a) and inserting in lieu thereof "$100,000".

SEC. 4. Section 15(c)(4) of the Securities Exchange Act of 1934 is amended to read as follows:

"(4) If the Commisions finds, after notice and opportunity for a hearing, that any person subject to the provisions of section 12, 13, 14, or subsection (d) of section 15 of this title or any rule or regulation thereunder has failed to comply with any such provision, rule, or regulation in any material respect, the Commission may publish its findings and issue an order requiring such person, and any person who was a cause of the failure to comply due to an act or omission the person knew or should have known

would contribute to the failure to comply, to comply, or to take steps to effect compliance, with such provision or such rule or regulation thereunder upon such terms and conditions and within such time as the Commission may specify in such order.".

SEC. 5. Section 20 of the Securities Exchange Act of 1934 is amended by adding at the end thereof the following:

"(d) Wherever communicating, or purchasing or selling a security while in possession of, material non-public information would violate, or result in liability to any purchaser or seller of the security under any provision of this title, or any rule or regulation thereunder, such conduct in connection with a purchase or sale of a put, call, straddle, option, or privilege with respect to such security or with respect to a group or index of securities including such security, shall also violate and result in comparable liability to any purchaser or seller of that security under such provision, rule, or regulation.".

SEC. 6. (a) Section(a)(39) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(39) is amended —

(1) by inserting before the semicolon at the end of subparagraph (A) the following: ", contract market designated pursuant to section 5 of the Commodity Exchange Act (7 U.S.C. 7), or futures association registered under section 17 of such Act (7 U.S.C. 21), or has been and is denied trading privileges on any such contract market";

(2) by inserting before the semicolon at the end of subparagraph (B) the following: ", or is subject to an order of the Commodity Futures Trading Commission denying, suspending, or revoking his regis-

tration under the Commodity Exchange Act (7 U.S.C. 1 et seq.)"; and

(3) by inserting after "municipal securities dealer," in subparagraph (C) the following: "or while associated with an entity or person required to be registered under the Commodity Exchange Act,".

(b) Section 15(b)(4) of such Act (15 U.S.C. 78o(b)(4) is amended —

(1) by striking out "or fiduciary" in subparagraph (1)(ii) and inserting in lieu thereof "fiduciary, or any entity or person required to be registered under the Commodity Exchange Act (7 U.S.C. 1 et seq.)"; and

(2) in subparagraph (C) —

(A) by inserting "entity or person required to be registered under the Commodity Exchange Act," before "or municipal securities dealer"; and

(B) by inserting "entity or person required to be registered under such Act," before "or insurance company"; and

(3) by inserting "the Commodity Exchange Act," after "Investment Company Act of 1940," each place it appears in subparagraphs (D) and (E).

SEC. 7. The amendments made by this Act shall become effective immediately upon enactment of this Act.

(Emphasis added).